

**MINUTES  
REGULAR MEETING  
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**Friday, May 20, 2005  
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10<sup>th</sup> Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Dr. Keith Meredith, Chair of the ASRS Board, called the meeting to order at 8:37 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

**1. Call to Order; Roll Call; Opening Remarks**

Present: Dr. Keith Meredith, Chair  
Mr. Karl Polen, Vice Chair  
Mr. David Byers  
Mr. Jaime Gutierrez (via teleconference)  
Mr. Chris Harris  
Ms. Anne Mariucci  
Mr. Lawrence Trachtenberg  
Mr. Steven Zeman

Absent: Mr. Michael Townsend

A quorum was present for the purpose of conducting business.

**2. Approval of the Consent Agenda**

At the request of Mr. David Byers, Dr. Meredith directed that Agenda Item 2D(i), Severiano Coronado, Jr., be removed from the Consent Agenda and discussed as a separate agenda item.

At the request of Mr. Jaime Gutierrez, Dr. Meredith directed that Agenda Item 2D(ii), Ray P. Stillings, be removed from the Consent Agenda and discussed as a separate agenda item.

**2D(i) - Severiano Coronado, Jr.** – Attorney N. Douglas Grimwood introduced himself and stated that he was representing Mr. Severiano Coronado, pro bono, regarding his application to the ASRS to purchase military reserve time to allow him to be eligible for normal retirement. Mr. Grimwood provided an overview of the documentation presented to the ASRS and conversations with various staff.

**2D(ii) - Tara S. Mitchell** – Ms. Tara Mitchell addressed the Board via telephone regarding her appeal to purchase service prior to August 1989.

**Motion:** Ms. Anne Mariucci moved to approve Refunds, Death Benefits and Retirements,

*And*

Approve the System Transfers,

*And*

Approve the minutes of the April 15, 2005 Regular Meeting and Executive Session of the ASRS Board,

*And*

Adopt the decision of the Administrative Law Judges of the Office of Administrative Hearings denying Tara S. Mitchell the right to purchase service occurring prior to August 1989 and denying Steven D. Floyd the right to purchase service at the normal cost rate.

Mr. Karl Polen seconded the motion.

By a vote of 8 in favor, 0 opposed, 0 abstentions, and 1 excused, the motion was approved.

Mr. Thomas McClory, Assistant Attorney General, advised the Board that with respect to appeals the Board has the following options; the Trustees may accept and approve the recommendations of the administrative law judge, amend the decision, reject the decision, or take no action and five days from today the decision of the administrative law judge becomes final.

There was discussion among the Trustees with Mr. McClory and Mr. Grimwood regarding the Findings of Fact. Mr. McClory recommended that the Board adopt the decisions of the Administrative Law Judge of the Office of Administrative Hearings which found that the ASRS had merely advised Mr. Coronado that his application would be processed and that Mr. Coronado's claim for relief against ASRS be denied.

**Motion:** Mr. Lawrence Trachtenberg moved to adopt the decision of the Administrative Law Judge of the Office of Administrative Hearings regarding Severiano Coronado Jr.

Mr. Steven Zeman seconded the motion.

By a vote of 6 in favor, 2 opposed (Jaime Gutierrez and Dave Byers), and 1 excused, the motion was approved.

**2D(iv) – Ray P Stillings** – Mr. Jaime Gutierrez stated that his request for further discussion of this appeal stemmed from the evidence that Mr. Stillings had met his burden of notifying the Oppenheimer Fund (OF) to transfer money to the ASRS to satisfy the purchase of other public service credit upon retirement within the required 90 days.

After discussion among the Trustees and Mr. McClory, there was general agreement by the Trustees that based on the findings, Mr. Stillings met his obligation of notifying the OF to transfer money to the ASRS and that the OF had been derelict in its response.

Ms. Nancy Johnson, Rules Coordinator, stated that the proposed final rules that are going to the Governor's Regulatory Review Council on June 7, include service purchase rules, which will allow for an extension of 60 days on the 90 day time period providing the member has followed all of the rules and met all of the timelines of the rules and that the money coming from a third party, which is generally earmarked for rollovers, just simply has not made it to the ASRS. Additionally, Ms. Johnson explained, the member should make a request for the extension in writing before the 90 day period is over to make it clear that the member is watching the situation.

**Motion:** Mr. Jaime Gutierrez moved that the Board reject the decision of the Administrative Law Judge. Based on the exercise of the Board's discretion and the facts of this case, the Board concludes that the ASRS policy that roll-over funds be transferred to the ASRS within 90 days of notice of cost be extended to allow Mr. Stillings an additional 90 days from today's date to complete the transfer.

Mr. Steven Zeman seconded the motion.

By a vote of 8 in favor, and 1 excused, the motion was approved.

### **3. Presentation, Discussion and Appropriate Action Regarding Simplifying The ASRS Rules Process**

Mr. Jaime Gutierrez stated that he would defer the presentation to Mr. Paul Matson, Director. Mr. Matson stated that there were essentially three phases in promulgating a rule: (1) notice to the Secretary of State; (2) the drafting of the proposed rule; and (3) acceptance and/or adoption of the final rule.

There was discussion regarding when the Board would become involved with the proposed rule making process. Ms. Johnson assured the Trustees that the Board as well as the External Affairs Committee, would still review and approve the proposed rules and the final rules.

**Motion:** Ms. Anne Mariucci moved that the Board approve the delegation of the first step in the regular rulemaking process, that of filing the Notice of Rulemaking Docket Opening, to the Director or the Director's designee, without the Board first approving the Notice.

Mr. Chris Harris seconded the motion.

By a vote of 8 in favor, and 1 excused, the motion was approved.

#### **4. Presentation, Discussion and Appropriate Action Regarding Status of Goldman Sachs Asset Management – U.S. Equity Large Cap**

Mr. Gary Dokes, Chief Investment Officer, stated the ASRS investment managers are evaluated and monitored on the following criteria: (1) performance, (2) risk return profile; (3) organizational issues; and, (4) news about the managers. He stated that today a recommendation was being presented to the Board regarding Goldman Sachs (GS), an ASRS U.S. Equity Large Cap Growth manager.

Mr. Dokes reported that GS was retained a little over two years ago to manage a large cap growth portfolio for the ASRS and there have been performance issues with this portfolio. Mr. Dokes provided an overview of the stock portfolio, and recommended terminating GS and transitioning the assets/cash of approximately \$306.1 million to INTECH, the other ASRS U.S. Equity Large Cap Growth Manager. The Investment Management Division staff would handle this transition over the next few days.

Mr. Dokes stated that this transition is reasonable and would (1) maintain the ASRS allocation to U.S. Equity Large Cap Active; (2) maintain the existing balance between the ASRS Large Cap Growth and Value; and (3) reflect the continued confidence in INTECH moving forward.

He indicated that this recommendation has been discussed internally, and discussed and approved by the Investment Committee.

**Motion:** Mr. David Byers moved that Goldman Sachs be terminated as an ASRS U.S. Equity Large Cap Growth investment manager;

*and*

Move that the ASRS transition assets/cash of approximately \$306.1 million from the Goldman Sachs' portfolio to INTECH, the other ASRS U.S. Equity Large Cap Growth Manager.

Mr. Karl Polen seconded the motion.

By a vote of 8 in favor, and 1 excused, the motion was approved.

#### **5. Presentation, Discussion and Appropriate Action Regarding the ASRS Domestic Large Cap Equity Manager(s) Review**

Mr. Gary Dokes stated that once a year, he and Mr. Terry Dennison, Consultant, Mercer Investment Consulting, make an official, formal overview presentation to the Board of the various asset classes. Mr. Dokes stated that today's presentation of the domestic large cap manager review was for information purposes only, and no action by the Board is requested.

Mr. Dokes explained that the presentation was broken out in two different areas: first, looking at the managers in aggregate; and, the second, for reviewing managers individually.

Mr. Dokes reported that the market value of the Large Cap Managers as of March 31, 2005 was just over \$8.5 billion, with a passive orientation in large cap. He explained that within the ASRS portfolio, there is a mix between the core (37%), growth (29%) and value (34%). Within the eight portfolios, there are three passive and five active, two of which are managed internally. He indicated that with the mix of active and passive, our fees are relatively low, given our high concentration in passive.

Mr. Dokes next reviewed the Annualized Excess Returns, which indicated how well the large cap managers performed relative to their benchmark. The graph presented was for a year-to-date basis, and he stated most of the managers did well. Mr. Dokes reviewed the Value Added in Dollars, which was a ten year history of the large cap managers.

**Franklin Portfolio Associates Attribution Analysis for Period Ending March 31, 2005**

	Quarter	1 Year	3 Years	5 Years	Inception 12/31/02
Stock Selection	0.36	0.52	---	---	0.99
Sector Selection	0.30	-0.25	---	---	0.46
Other	0.38	0.87	---	---	0.11
Fees	-0.03	-0.12	---	---	-0.12
Excess Return	1.01	1.02	---	---	1.44

- No organization concerns at this time.
- Franklin outperformed its benchmark and placed above the universe median for all periods evaluated.

**Goldman Sachs Attribution Analysis for Period Ending March 31, 2005**

	Quarter	1 Year	3 Years	5 Years	Inception 12/31/02
Stock Selection	-1.21	1.98	---	---	0.83
Sector Selection	-3.51	-7.32	---	---	-3.67
Other	0.00	0.00	---	---	0.00
Fees	-0.10	-0.41	---	---	-0.41
Excess Return	-4.82	-5.75	---	---	-3.25

- No organization concerns at this time.
- Goldman Sachs underperformed its benchmark and placed in the bottom decile of the universe for all periods evaluated.

**INTECH Attribution Analysis for Period Ending March 31, 2005**

	Quarter	1 Year	3 Years	5 Years	Inception 12/31/02
Change in Diversity (size effect)	1.24	4.71	---	---	5.20
Alpha Generator	-0.19	0.54	---	---	1.08
Other	0.00	0.00	---	---	0.00
Fees	-0.11	-0.43	---	---	-0.43
Excess Return	0.94	4.82	---	---	5.85

- No organization concerns at this time.
- INTECH outperformed its benchmark and placed in the top quartile of the universe for all periods evaluated.

**LSV Asset Management Attribution Analysis for Period Ending March 31, 2005**

	Quarter	1 Year	3 Years	5 Years	Inception 12/31/02
Stock Selection	1.32	2.30	---	---	3.06
Sector Selection	1.51	1.40	---	---	0.70
Other	0.00	1.10	---	---	0.70
Fees	-0.07	-0.30	---	---	-0.30
Excess Return	2.76	4.50	---	---	4.16

- No organization concerns at this time.
- LSV outperformed its benchmark and the universe median for all periods evaluated.

**State Street Global Advisors Attribution Analysis for Period Ending March 31, 2005**

	Quarter	1 Year	3 Years	5 Years	Inception 12/31/02
Stock Selection	1.57	-0.28	---	---	-7.36
Sector Selection	0.40	-0.09	---	---	-1.00
Other	0.42	1.17	---	---	7.93
Fees	-0.05	-0.21	---	---	-0.21
Excess Return	2.36	0.59	---	---	-0.64

- Alan Brown, SSgA's CIO, resigned from his post on March 18. Mercer does not anticipate Brown's resignation to significantly impact the performance or direction of the firm, given the highly structured nature of its investment offerings.
- Tony Foley, head of SSgA's Advanced Research Center (ARC) resigned on April 25. The ARC team consists of 22 individuals with plans to expand to 30 in the near future. As a result of this depth, Mercer does not expect the departures to materially impact the research produced by ARC.
- State Street outperformed its benchmark for the recent quarter and 1 year but underperformed the benchmark since inception. For all periods evaluated, the portfolio placed below the universe median.

**ASRS E1 Assessment**

- The ASRS E1 portfolio was within 0.2% of the index for all periods evaluated.

**ASRS E2 Assessment**

- The ASRS E2 portfolio was within 0.1% of the index for all periods evaluated.

**Barclays Global Investors Assessment**

- No organization concerns at this time.
- BGI is tracking the benchmark as expected.

Mr. Dokes responded to Ms. Mariucci's question regarding performance (excess returns) by stating that they were net of fees.

## **6. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance Overview for the Period Ending March 2005**

Mr. Terry Dennison reported on the first quarter 2005 economy and that growth has continued to expand, the unemployment rate fell during the quarter, higher oil prices dented consumer confidence and the housing market remained solid. He stated that there are a lot of negative factors that are beginning to accumulate. The current recovery is into its fourth year, which is about the typical time for many recoveries to start running out of steam.

Mr. Dennison voiced that there are a number of positive economic factors to counterbalance the negatives. Employment continues to grow; industrial production, retail sales, durable goods orders and housing are still expanding at a moderate pace; exchange rates should favor U.S. exports and inflation, albeit higher, is not out of control.

Mr. Dennison reported on the U.S. Equity Markets. He stated that the stock market faltered during the first quarter, small cap stocks underperformed large caps, large cap value stocks outperformed large growth stocks and commodity-driven sectors led the market.

Mr. Dennison reported on the Total Fund Performance for the period ending March 31, 2005.

	<b>Quarter</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>	<b>Inception(6/30/75)</b>
<b>ASRS Total Fund</b>	-1.3%	6.7%	6.2%	1.6%	10.0%	10.9%
<b>Benchmark*</b>	-1.3%	6.6%	5.7%	0.7%	8.7%	9.2%
<b>Excess Return</b>	0.0%	0.1%	0.5%	0.9%	1.3%	1.7%

Dr. Meredith stated that one of the Trustees would be leaving the meeting early and there would be a slight change in the agenda order.

## **9. Presentation, Discussion and Appropriate Action Regarding the Election of Board Officers**

Dr. Meredith stated that elections are needed for the positions of Chair and Vice Chair to serve July 1, 2005 through June 30, 2006.

**Motion:** Mr. Steven Zeman moved that based on his leadership and accomplishments as Chair and to assure the continued effectiveness of the Board, Dr. Keith Meredith be nominated to serve a second term as Chair of the ASRS Board.

Mr. Karl Polen seconded the motion.

By a vote of 7 in favor, 1 abstention and 1 excused the motion was approved.

**Motion:** Mr. Steven Zeman moved that based on his leadership and accomplishments as Vice Chair and to assure the continued effectiveness of the Board, Mr. Karl Polen be nominated to serve a second term as Vice Chair of the ASRS Board.

By a vote of 7 in favor, 1 abstention and 1 excused the motion was approved.

With agenda item 9 having been concluded, the meeting returned to its original agenda order.

## **7. Presentation, Discussion and Appropriate Action Regarding the Performance of ASRS Service and Business Operations**

Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, stated that the focus of this report is on the ASRS' ability to meet the following fundamental goals:

- Easy access to expert counseling, information, and service
- Timely and reliable estimates and cost calculations
- Timely, reliable calculations and disbursements of benefits and payments
- Timely, reliable collections and adjustments of contributions and data needed to maintain member accounts
- Timely, reliable financial statements

Mr. Guarino reported that the business plan to action of meet these goals is:

- Re-engineer major business functions and services
- Update policies, procedures, and rules
- Install call center interaction center
- Develop a relational database and applications
- Develop an imaging system
- Develop automated workflows
- Business areas with staff to fit future needs

He reported that re-engineering started in July 2001, with a completion date of December 2007, and a cost of \$44.7 million.

Mr. Guarino stated that this plan was not without challenges, but would increase turnaround time, productivity, cost efficiency, benefit accuracy, and help to increase member satisfaction.

Mr. Guarino also stated that a previous consultant raised some concerns about the plan and as a result the Director organized a mid-term review. Since that time, an independent consulting firm was hired to make an assessment of the plan. The plan has been reviewed from top to bottom with the conclusion that we are largely succeeding.



## **8. State Legislation for the 2005 Legislative Session Relating to the ASRS.**

Mr. Jaime Gutierrez, Chair of the External Affairs Committee, commented on how busy the session was for staff and the great job staff did providing the Trustees up-to-date information during the session.

Ms. Denisse Gee, Government Relations Officer, spoke regarding various bills that might impact the ASRS. The following bills were discussed: HB2472, HB2474, HB2552, HB2562, HB2621, HB2671, HB2772/SB1521, SB1360, SB1513/HB2764.

## **10. Director's Report**

Mr. Paul Matson, Director pointed out that because of three things; sine e die, the ASRS budget, and fact that we are half way through this calendar year, staff will start a series of strategy meetings over the next few weeks. The meeting topics will be the budget, how we allocate resources, outstanding projects for the remainder of the calendar year, both at the board level and staff level, prioritizations and review of the IT plan.

## **11. Possible Presentation and Discussion Regarding Board Committee Updates**

Mr. Jaime Gutierrez, Chair, External Affairs Committee, reported that there would be no June meeting of the External Affairs Committee.

Mr. Lawrence Trachtenberg, Chair, Investment Committee, reported that the Committee is currently working on the international manager selection process.

In the absence of Mr. Michael Townsend, Chair, Operations Committee, Mr. Guarino reported that there will be an Operations Committee Meeting on May 26, 2005.

## **12. Board Requests for Agenda Items**

Dr. Keith Meredith called for Board Requests for Agenda Items. There were no requests made.

## **13. Call to the Public**

Dr. Keith Meredith recognized Dr. Bob Letson, a retired member from the University of Arizona, who was participating telephonically from the Tucson office. Dr. Letson reiterated his statements at last month's Board meeting regarding SB 1426, Spousal Consent, and the strong support for this bill given by the University of Arizona retiree group.

Dr. Letson commended Dr. Meredith and Mr. Karl Polen for their reappointment to the Chair and Vice Chair positions. Dr. Letson also stated his appreciation for Mr. Terry Dennison's reports.

**14. The next ASRS Board meeting is scheduled for Friday, July 15, 2005 at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.**

**15. Adjournment of the ASRS Board**

Dr. Meredith adjourned the May 20, 2005 Board meeting at 11:20 p.m.

ARIZONA STATE RETIREMENT SYSTEM

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Gayle Norman, Secretary

Date

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Paul Matson, Director

Date